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June 29, 1994

Mr. William F. Caton
Secretary
Federal Communications Commission
Room 222
1919 M Street, NW
Washington, DC 20554

Re: CC Docket No. 94-1; Price Cap Performance Review for Local Exchange Carriers

Dear Mr. Caton:

Enclosed herewith for filing are the original and four (4) copies of MCI Telecommunications Corporation's Reply Comments in the above-captioned proceeding.

Please acknowledge receipt by affixing an appropriate notation on the copy of the MCI Reply Comments furnished for such purpose and remit same to the bearer.

Sincerely yours,

Elizabeth Dickerson

Elizabeth Dickerson
Manager, Federal Regulatory

Enclosure
ED/ms

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Before the
FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of	)	
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Price Cap Performance Review for Local Exchange Carriers	)))	CC Docket No. 94-1

REPLY COMMENTS OF

MCI TELECOMMUNICATIONS CORPORATION

Elizabeth Dickerson
Manager, Federal Regulatory
1801 Pennsylvania Avenue, NW
Washington, DC 20006
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June 29, 1994

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SUMMARY

The local exchange carriers reveal themselves to be a most unhappy lot. Price cap regulation, which was supposed to free them from the bonds of rate-of-return regulation and its strict adherence to earnings limitations, has apparently disappointed those whom the Commission believed it would benefit. The LECs solemnly advise that the Commission, in its zeal to dispatch its statutory obligations to protect ratepayers from unreasonably high rates, has quashed what incentives there might be to become more efficient and innovative. To make matters worse, say the LECs, competitive forces have been unleashed against them, and they struggle to compete in a regulatory environment that handicaps them with onerous and burdensome requirements.

To the LECs, the only way out of this regulated purgatory is reform. They bring to this performance review an ambitious agenda. Only if a host of changes are made to the current price cap plan (e.g., elimination of sharing, Part 69 Switched Access rules, and rate structure prescription; increased pricing flexibility; wholesale basket revisions; reduction of the productivity offset to 1.7 percent; and granting them all the benefits of common line demand growth) will the LECs be able to subsist, much less be empowered to achieve the economic miracles that surely will result from their proposed modifications.

Such a story blatantly ignores the reality that the balance of benifitts from price cap regulation tilted too far in the LECs' direction. The LECs have benefitted handsomely -- achieving earnings well over the cost of capital at

which the plan was initialized (11.25 percent) in an economy characterized by slow growth and declining interest rates. The ratepayers have fared less well. LEC shareholder benefits from the plan have eclipsed ratepayer benefits by over $900 million.[1] Instead of being overjoyed with these results, the LECs attempt to persuade the Commission to endorse their precept that access competition is both robust and menacing, and regulatory relief is essential. They seek relaxation of much of the ratepayer protection that the Commission has created, while asking the Commission to assign a few requirements to their burgeoning competitors as well. This new regulatory fantasy does not match the actual state of competition that the LECs face today, or will encounter in the next few years.

To ensure that competition can develop, MCI encourages the Commission to increase the LECs' productivity factor, thus driving LEC rates toward economic cost and encouraging the LECs to invest in state-of-the-art technologies to achieve their productivity goals. There must be a one-time adjustment return to the ratepayers what otherwise would be windfall profits that the LECs did not earn, but which resulted from the overly conservative initial selection of a 3.3 percent productivity factor and the declining interest rates. Further, the sharing mechanism must both be retained and readjusted to reflect the contemporary cost of capital in order to ensure that LECs do not achieve monopoly profits and so that the Commission can maintain an enforcement

[1] MCI Comments, p. 3.

mechanism. Finally, it would be premature for the Commission to relax any LEC regulations such as affiliate transaction and depreciation calculation rules because absent effective competition, the LECs retain their ability to cross-subsidize competitive ventures to the detriment of both ratepayers and emerging competitors.

In sum, MCI advocates a regulatory environment that supports the development of competition rather than one that enables the LECs to further tighten the grip on their monopoly strongholds.

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REPLY COMMENTS OF MCI TELECOMMUNICATIONS CORPORATION

INTRODUCTION

In their comments filed in response to the Commission's Notice of Proposed Rulemaking[2] the local exchange carriers ("LECs") reveal themselves to be a most unhappy lot. Price cap regulation, which was supposed to free them from the bonds of rate-of-return regulation and its strict adherence to earnings limitations, has apparently been a disappointment to those whom the Commission believed would benefit from it. The LECs solemnly advise that the Commission, in its zeal to dispatch its statutory obligations to protect ratepayers from unreasonably high rates, has quashed what incentives there might be to become more efficient and innovative. To make matters worse, say the LECs, competitive forces have been unleashed against them, and they struggle to compete in a regulatory environment that handicaps them with onerous and burdensome requirements.

[2] Price Cap Performance Review for Local Exchange Carriers, Notice of Proposed Rulemaking, CC Docket No. 94-1, 9 FCC Rcd 1687 (1994) ("Notice").

To the LECs, the only way out of this regulated purgatory is reform. They bring to this performance review an ambitious agenda. Among the changes the LECs would make to the price cap plan:

- eliminate sharing;
- eliminate Part 69 Switched Access rate structure prescription;
- increase pricing flexibility to account for competition;
- make wholesale revisions to baskets;
- decrease the productivity offset to 1.7 percent from 3.3 percent; and
- ensure that LECs (not interexchange carriers, "IXCs") capture all the benefits of Common Line demand growth

If the Commission adopts this agenda, say the LECs, nothing short of an economic miracle will occur:

- Gross Domestic Product grows by $60 billion
- automobile sales increase by 100,000 units
- new home starts increase by 30,000 units
- over 500,000 new jobs are created; and
- inflation rate slows by 0.15 percent per year

As the clouds part and the sun finally emerges, the LECs promise to be there with a ubiquitous, state-of-the-art information superhighway.

Noticeably missing from this crocodile tears view of the last four years and the smoke-and-mirrors view of the plan to come, is any discussion of how rate payers have fared, or will fare, under the plan.

LEC performance data sustain MCI's conviction that the first iteration of the price cap plan failed to balance ratepayer benefits and shareholder benefits adequately. As MCI noted in its comments, the average price cap company that enrolled in the plan from the beginning is now earning 1.6 percent over the limit at which rate of return companies' earnings are capped. This robust earnings performance, compared, not with the 11.25 percent initial rate of return the Commission calculated in 1990, but with the prevailing 9.5 percent cost of capital that exists today (and that prevailed during much of the period under review). Viewed this way, the LECs are reaping enormous profits -- as a group, they earn 3.35 percent over the prevailing cost of capital. The LECs have benefitted from the lower cost of capital in another way -- because the lower formula adjustment mechanism is currently set at 10.25 percent, the LECs receive an automatic and permanent adjustment to their price cap indexes even in cases where they are earning in excess of the prevailing cost of capital of 9.5 percent.

While the LECs have overwhelmingly benefitted from the system, ratepayers have fared less well. As MCI stated in its comments, LEC shareholder benefits from the plan have eclipsed ratepayer benefits by over $900 million.[3] One would expect the LECs to be overjoyed with these results. Surprisingly, they are disappointed.

Among other complaints, the LECs claim the productivity hurdle is too high. They propose a new factor, and a different common line formula, that would

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[3] MCI Comments, p. 3.

have equated to a factor of -0.2 percent during the past four years. If the Commission had heeded such advice four years ago, rates would have been almost $4 billion greater during the first three years of the original price cap plan. MCI urges the Commission to incorporate more rigorous features into the price cap plan that will propel LECs towards economic cost-based rates and the accompanying competitive behavior.

Meanwhile, the LECs attempt to persuade the Commission to endorse their precept that access competition is both robust and menacing. Not only do they pursue relief from most of the ratepayer protection that the Commission has created -- by seeking greater pricing and rate structure flexibility, reduced tariff notice periods and cost support and demand data reporting, higher depreciation expense, and the elimination of excess profit sharing -- but they ask the Commission to assign a few requirements to their burgeoning competitors as well. Most significantly (and most ludicrously), the LECs would have the Commission require the competitive access providers ("CAPs") to submit detailed descriptions of their serving areas -- down to the detail of the customers' names and addresses.

The LECs seek this regulatory parity in the name of "balanced competition," an undefined term that appears to guarantee a LEC dominance in the access market. The CAPs do not need to be encumbered with any reporting requirements nor do the LECs need to be released from any regulations. The

CAPs do not offer the LECs price constraining competition. Indeed, the LECs face very little competition at all.

The LECs propose rule changes and price cap modifications that are more appropriate in a market where effective competition already exists. MCI looks forward to the day when competition presents it with reasonable choices of access providers and LEC regulation can be relaxed. Such a scenario, however, will not likely materialize in the few short years following this review. Until such time as access competition reaches the level where it can effectively restrain LEC pricing behavior, regulation must operate in lieu of competitive forces.

GENERAL ISSUE 1

Whether and how the Commission should revise the goals of the LEC price cap plan so that the plan may better achieve the purposes of the Communications Act and the public interest.

In the initial comments MCI filed in the instant proceeding, it urged the Commission to augment the original price cap goals by adopting the goal of promoting the development of competition in the interstate access market."[4] While the price cap proceeding pre-dated resolution of the Commission's Expanded Interconnection and Transport reform dockets,[5] and hence was not

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[4] MCI Comments, p. 8.

[5] Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141, Report and Order and Notice of Proposed Rulemaking, 7 FCC Rcd 7369 (1992) ("Expanded Interconnection Order"), modified on recon., 8 FCC Rcd 127 (1992), modified on second recon., 8 FCC Rcd 7341 (1993), petitions for recon. pending, ref'd and remanded Bell Atlantic Corp. v. FCC, No. 92-1619 (slip

addressed to issues of interstate access competition, the Commission's groundbreaking decisions to open LEC networks to competitive providers have required the Commission to reconcile its pro-competitive policies with its regulation of price cap LECs. The reason for this linkage is the Commission's desire to create limited pricing flexibility for LECs to permit them to respond to emerging competition for trunking services.[6] Since price cap regulation is the vehicle that defines LEC pricing flexibility (e.g., through the design of service baskets, categories, rate bands, and procedural tariffing rules), the Commission should take the opportunity presented by this Performance Review to explicitly include a goal of promoting competition in the interstate access market, thus acknowledging the role price cap regulation will play as interstate access markets move toward a competitive future.

The LECs champion additional goals that are outside the scope of the price cap program, or are ill-advised. For example, the United States Telephone Association, ("USTA," and numerous USTA member LECs who support USTA's position[7]) believes that the price cap plan goals should be expanded to include

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op.)(D.C. Cir., June 10, 1994); see also, CC Docket No. 91-141, Second Report and Order, 8 FCC Rcd 7374 (1993); see also, Transport Rate Structure and Pricing, CC Docket No. 91-213, 7 FCC Rcd 7006 (1992), petition for recon. pending, modified on recon., 8 FCC Rcd 5370 (1993), modified on second recon., 8 FCC Rcd 6233 (1993), petitions for recon. pending, appeal dismissed sub nom. New England Tel. and Tel. Corp. v. FCC, No. 93-1670 (D.C. Cir., filed Oct. 1993).

[6] Expanded Interconnection Order, 7 FCC Rcd at 7451-58.

[7] See, e.g., BellSouth Comments, p. 12.; GTE Comments, p. 84.; and US WEST Comments, p. 28.

"promot[ing] universal service."[8] Such a goal disregards the fact that the price cap model is first and foremost, a tariff review process that defines which tariff filings will be subject to suspension. Universal service policy should be addressed in a separate proceeding in which issues of who funds the program and who benefits from it, can be resolved in a docket that is not limited to a particular sector of the industry.

For similar reasons, the Commission should also reject USTA's proposal that the goal of price caps be to "encourage the development of a national information infrastructure [("NII")]."[9] As with universal service, the Commission should be wary of creating a "goal" in a docket that applies solely to the LECs, when the issue is one that affects the entire industry. The Commission should avoid assigning a single segment of the industry a special role in the development of the information superhighway.

Certain other of USTA's and BellSouth's suggested goals are already subsumed in the Commission's existing goal of creating a regulatory program that provides incentives for LEC productivity and efficiency. The LECs argue that the addition of goals to "stimulate economic growth,"[10] "promote the efficient use of the network,"[11] and "promote job creation and stimulation of macroeconomic

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8 USTA Comments, p. 3.

9 Id. at 4.

10 USTA Comments, pp. 3-4; and BellSouth Comments, pp. 12-13.

11 USTA Comments, pp. 3-4.

growth"[12] are advisable. These "goals" have already been discussed in the original AT&T and LEC price cap decisions as potential secondary or tertiary effects of a regulatory program that rewards and promotes productivity.[13] In their comments, however, the LECs have failed to demonstrate why these potential benefits of a price cap plan should be singled out and named as "goals" for this proceeding.

Moreover, with respect to the LECs' suggestions that economic growth and job creation be named as goals in this proceeding, there is good reason for the Commission to proceed cautiously. These potential benefits are not listed as responsibilities of the Commission in the Communications Act. Fundamentally, the Commission is required to administer the price cap program to ensure just, reasonable, and nondiscriminatory rates.[14] The Commission cannot, for example, tolerate demonstrably unreasonable rates even if doing so allegedly has a positive effect on job creation. MCI urges the Commission to reject these additional "goals" suggested by the LECs.

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[12] BellSouth Comments, pp. 12-13.

[13] Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 887-313, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873, 2907-13, 2922-23 (1989) ("AT&T Price Cap Order"), modified on recon., 6 FCC Rcd 665 (1990) ("AT&T Price Cap Reconsideration Order), remanded on other grounds AT&T v FCC, 974 F2d 1351 (D.C. Cir. 1992); 5 FCC Rcd 6786 (1990) ("LEC Price Cap Order"), Erratum, 5 FCC Rcd 7664 (Com. Car. Bur. 1990), modified on recon., 6 FCC Rcd 2637 (1991) ("LEC Reconsideration Order"), aff'd, National Rural Telecom Ass'n v. FCC, 988 F.2d 174 (D.C. Cir. 1993).

[14] 47 U.S.C. §§ 201, 202.

The LECs also seek "balanced competition" in access markets.[15] The LECs would have the Commission believe that competition must be "balanced" to avoid stifling the LECs' ability to compete in the markets in which they have historically held monopoly control. MCI is not clear what "balanced" competition is, but it knows an adjective when it sees one, and recognizes that "balanced" competition must mean something different than the unmodified "competition" that MCI has advocated over many decades. MCI is therefore concerned that adoption of "balanced" competition as a goal in the price cap proceeding may undercut the Commission's competitive policies that are the subject of the Expanded Interconnection and Transport dockets.

Finally, US WEST includes as goals, certain strategies that are more appropriately discussed in the Baseline Issues. For example, it encourages the Commission "to remove the last remnants of rate of return regulation from price cap regulation; to modify the price cap plan to accommodate competition in those areas where it exists or is evolving; and to streamline the rules for introducing new services."[16] Each of these matters is addressed infra, and the Commission should not adopt these self-serving strategies as goals.

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15 USTA Comments, pp. 3-4 and BellSouth Comments, pp. 12-13.

16 US WEST Comments, p. 23.

GENERAL ISSUE 2

The effect of the price cap plan on consumer welfare, the economy, and the creation of jobs both in telecommunications and in other sectors of the economy.

In its comments, MCI stated that the price cap plan would provide the maximum benefits to the economy only if it resulted in LECs moving prices toward economic costs. Such a mandate would ensure that customers received services at the lowest possible cost consistent with the LECs' earning a reasonable profit.[17] So long as telecommunications prices are an important input into the production of other goods and services, it is a truism that lowering an input price can lead to a productivity improvement in the general economy.[18] Unlike other parties, however, MCI did not submit an econometric study of the effects of a particular regulatory plan on the economy for a simple reason: any forecast of the economic impact of changes in the price cap plan can readily be manipulated through selection of input data and assumptions. As a result, the value of such studies to decision-makers, is highly marginal, at best.

USTA did file a study the WEFA Group ("WEFA") conducted that purports to examine the effect of USTA's proposed changes in the price cap plan on the United States economy over the next ten years.[19] This study claims that,

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[17] MCI Comments, p. 10.

[18] Productivity increases if the same amount of outputs is produced with a smaller number of inputs or if additional outputs are produced with the same amount of inputs.

[19] USTA Comments, pp. 96-101.

compared to the case where there is no change in the LEC price cap plan, employment would rise by 500,000 jobs, Gross Domestic Product would be $60.5 billion higher by 2004, inflation would be 0.15 percentage points lower each year, the balance of trade would improve by a cumulative $16 billion over ten years, and the federal budget deficit would be lower by a cumulative $149 billion over ten years.[20]

As is usual with LEC econometric studies, the results depend on the assumptions of which variables should be included and how they are varied. The assumptions underlying WEFA's study are that USTA's proposed changes to the price cap plan will (1) increase investment by the LECs, (2) improve quality in telecommunications services, and (3) accelerate the economy-wide rate of technological change.[21] Accepting any of these propositions amounts to a significant leap of faith, one which the LECs have asked the Commission to make many times. Stated more baldly, the LECs promise to increase investment and improve quality, but only if regulators permit them to raise rates. These empty promises are one of the reasons that the Commission turned its back on rate of return regulation four years ago, and created a price cap system that puts the onus on the LECs to make investment decisions. Old habits die hard.

There are other problems of a more technical nature with the design of WEFA's study. Significantly missing from WEFA's assumptions is any estimate

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[20] Id.

[21] See id., Attachment 7, pp. 7-11.

of price changes, which will affect demand for telecommunications services and change the costs of all sectors of the economy that use telecommunications services. Also absent is any discussion of the net effect on investment of USTA's proposed changes. Further, the assumption that quality and investment would increase focuses only on changes by the LECs, and ignores any offsetting reduction in the IXC industry or in other segments of the telecommunications sector.

This study deserves no credence at all. In addition to the empty promises and unsupported assumptions, the WEFA study is premised on USTA's proposal to lower the LECs' productivity factor to 1.7 percent. If the WEFA study is to be believed, lower productivity is good for the economy. This is, of course, utter nonsense. The LECs have wasted and continue to waste hundreds of thousands of ratepayer dollars funding studies such as this one, which is based on implausible assumptions and therefore reaches insupportable conclusions.

Because of the difficulty of integrating unbiased assumptions into any study that attempts to predict the effect of the price cap plan on the entire economy, a study such as USTA's should play no role in the Commission's decision in the instant proceeding. Instead, the Commission should focus on moving prices towards cost and encouraging competition to develop. In this way, price caps can help achieve maximum economic benefits.

BASELINE ISSUE 1: INFRASTRUCTURE DEVELOPMENT

Baseline Issue 1a: Whether, and if so how, the Commission should revise the LEC price cap plan to support the development of a ubiquitous national information infrastructure.

As in the initial proceeding adopting LEC price cap regulation, the LECs tempt policymakers with promises of futuristic technology if only they could be granted the "freedom" to generate revenues to underwrite the multimedia future. Four years ago, these same arguments were influential in the adoption of a plan that was generous to a fault.[22] The fault was -- and remains -- that neither ratepayers nor policymakers has any ability to measure whether the revenue benefits granted to LECs in the beginning -- benefits explicitly targeted for infrastructure development -- resulted in a single investment that would not have been otherwise made. While price cap reporting requirements reveal to some degree how the LECs invested in plant and equipment in the last three years, they do not reveal whether those same investments would have been made in any case, or whether additional earnings should have been invested.[23] Nevertheless, having been so successful with their infrastructure promises in the past, the LECs are back again, spinning tales of information superhighways that could be built if only the regulators would order the ratepayers to front the investment dollars through interstate access rate increases.

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[22] Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers, CC Docket No. 89-624, Order, 5 FCC Rcd 7507, 7530 (1991).

[23] See ARMIS Report 4302.

For example, several of the LECs contend that the pot of gold the existing price cap plan offers does not provide enough incentive for them to invest their increased and excessive earnings into the network that generated those very profits. Sprint, for example, opines that "[e]limination of profitability restraints would make LEC investment in new technologies, features and functions in their regulated operations even more attractive because LECs would then be afforded an expanded opportunity to retain and reinvest a greater portion of the earnings generated by that investment."[24] Southwestern Bell fears that "[w]ithout a regulatory framework that enables the LECs to equitably compete, and to retain the benefits of their efficiencies and investments, the turn of the century will find us looking back on the NII as an unfulfilled promise."[25] Thus, it recommends other revisions to the plan: "eliminate regulation of LEC earnings, provide for pricing flexibility, and provide regulatory parity, whereby regulatory constraints for incumbents are relaxed rather than imposing existing constraints on new entrants."[26]

Other parties commenting in this proceeding also seek increased earnings and additional flexibility and incentives for the LECs. For example, the American

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[24] Sprint Comments, p. 6. See also NYNEX Comments, p. 30 (retention of sharing mechanism discourages investment in regulated operations); Southwestern Bell Comments, p. 44 (sharing mechanism forces management to invest in lines of business without earnings regulation); and USTA Comments, p. 47 (with sharing, global money market will direct funds away from regulated businesses).

[25] Southwestern Bell Comments, p. 68.

[26] Id.

Library Association suggests that LEC connection of libraries in their service areas could be achieved "by allowing greater flexibility on earnings under the price cap rules provided that a LEC agrees to invest in connecting public facilities such as libraries to the NII."[27] The Council of Chief State School Officers, and the National Association of Secondary School Principals also urge the Commission to "develop appropriate incentives to encourage LECs to connect all elementary and secondary school classrooms in their service areas to the NII."[28] Similarly, the Computer & Communications Industry Association suggests that:

> the Commission offer LECs more favorable treatment under FCC Price cap regulation -- i.e., relief from "sharing," depreciation and the "baseline" productivity factor, individually, or in the combination -- in return for providing advanced inside wiring facilities to the Nation's 2 million classrooms, as well as to its public libraries.[29]

These arguments pander to the desire of policymakers to deliver the "gee whiz" information technologies of tomorrow. MCI believes the Commission should proceed with a great deal of caution before abandoning its current policy direction, i.e., to create the conditions necessary for competition and allow competitive forces to create a diverse and feature-rich network of networks.[30] LEC argu-

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[27] American Library Association Comments, p. 2.

[28] The Council of Chief State School Officers, and The National Association of Secondary School Principals Comments, p. 2.

[29] Computer & Communications Industry Association Comments, pp. 14-15.

[30] A pro-competitive infrastructure policy will in the long run limit the power of the LECs to impose their decisions on regulators, ratepayers, and competitors:

ments in favor of anointing themselves as universal service providers of an advanced information superhighway raise difficult policy choices for the Commission, which the LECs have failed to brief in their comments. The threshold issue is the definition of a "ubiquitous national information infrastructure." While the NII is generally described using words such as "seamless" and "information superhighway," there is no regulatory definition of what the NII is.[31] Yet the LECs want their interstate ratepayers to fund it before anyone -- even the Commission -- has defined it. Nor has the Commission begun to address how to reshape universal service policies in a competitive world, and whether the "carrier of last resort" could be an entity other than a LEC.[32]

A second problem is that, despite the wishes and desires of some local customers to have "free" service, there is no free lunch. Furthermore, LEC offers

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> As James Madison wrote (under the pseudonym Publius) in Federalist Paper No. 10, nothing was more important to a well-constructed union than avoiding the imposition on all citizens of measures favored by narrow factions.

Madison, James, The Federalist Papers, Mentor Book Edition (New York: New American Library, 1961), pp. 77-84, quoted in F.M. Sherer and D. Ross, Industrial Market Structure and Economic Performance (3rd Ed. 1990)(discussing case for competition).

[31] Indeed, the United States Department of Commerce currently has an advisory council evaluating a number of issues that will assist in defining what the NII will be.

[32] See, e.g., Petition of MFS Communications Company, Inc. for a Notice of Inquiry and En Banc Hearings, filed November 1, 1993; Ad Hoc Telecommunications Users Committee, Petition for Rulemaking, filed April 15, 1994. MCI has filed a white paper as an ex parte in the MFS proceeding: "From a Single Lane to the Superhighway: Rethinking Universal Service Policy for the 21st Century Consumer."

to fund infrastructure investments out of "excess" profits belie the source of those "excess" profits. If the LECs reap high profits from their interstate access customers and reinvest them into the infrastructure, or provide "free" service, rather than rates to their customers, it is essentially the interstate access customer who funds the NII. For example, Pacific Telesis boasts of its wiring and providing "free" service for schools and libraries:

> By the end of 1996, we will have wired each of the nearly 7,400 public K-12 schools, public libraries, and community colleges in Pacific Bell territory for computer communications and video conferencing. Pending approval by the California Public Utilities Commission (the CPUC), the <u>service at these locations will be installed for free, and usage charges will be waived for a year after installation</u>.[33]

What Pacific fails to disclose, however, is that it made this generous offer only as part of an overall strategy to thwart efforts by CPUC Staff and numerous ratepayer interest groups to reduce Pacific's rates during the CPUC's triennial review of its performance under incentive regulation. This strategy is reflected in several <u>ex parte</u> communications with CPUC Commissioners, in which Pacific explicitly has linked its future deployment plans for fiber and other advanced infrastructure facilities to reduction or removal of productivity offsets, sharable earnings targets, and exogenous factors from its incentive regulation plan. In essence, Pacific consistently has indicated to the CPUC that if its rates were to be lowered to "just and reasonable levels," Pacific would not possess sufficient funds for infrastructure development.

[33] Pacific Telesis Comments, p. 20 (emphasis supplied).